M&G Short Dated Corporate Bond Fund

a sub-fund of M&G Investment Funds (2)

Interim Short Report November 2018
For the six months ended 30 November 2018

M&G INVESTMENTS

Fund information

The Authorised Corporate Director (ACD) of M&G Investment Funds (2) presents its Interim Short Report for M&G Short Dated Corporate Bond Fund which contains a review of the fund's investment activities and investment performance during the period. The ACD's Interim Long Report and unaudited Financial Statements for M&G Investment Funds (2), incorporating all the sub-funds and a Glossary of terms is available free of charge either from our website at www.mandg.co.uk/reports or by calling M&G Customer Relations on 0800 390 390.

ACD

M&G Securities Limited, Laurence Pountney Hill,
London EC4R 0HH Telephone: 0800 390 390

(Authorised and regulated by the Financial Conduct Authority. M&G Securities Limited is a member of the Investment Association and of the Tax Incentivised Savings Association.)

Important information

As a result of the Extraordinary General Meetings of Shareholders held on 4 October 2018, the non-sterling share classes of the M&G Short Dated Corporate Bond Fund were merged into corresponding share classes of the equivalent sub-fund in M&G (Lux) Investment Funds 1. The effective date of the merger for the M&G Short Dated Corporate Bond Fund was 26 October 2018. For further details of the merger, please refer to www.mandg.com/brexitmergerdocumentation.

On 28 September 2018 the Depositary changed from National Westminster Bank Plc to NatWest Trustee and Depositary Services Limited.

Investment objective

The fund aims to provide a total return (the combination of capital growth and income).

Investment policy

At least 80% of the fund is invested in investment grade corporate bonds (including variable rate securities and fixed income securities). The fund invests in securities which on aggregate produce a low portfolio duration, in order to limit the effect of interest rate movements on the fund's capital value. These securities may be issued anywhere in the world. The fund aims to hedge any non-GBP assets to GBP.

Derivatives can be used to meet the fund's investment objective and for efficient portfolio management.

The fund may also invest in other debt securities (including government and public securities denominated in any currency), collective investment schemes, other transferable securities, cash, near cash, other money market securities, warrants, and other derivative instruments.

Investment approach

The fund manager combines a top-down assessment of macroeconomic factors with a bottom-up approach to individual stock selection.

Duration is a measure of a bond's or a bond fund's sensitivity to changes in interest rates. Consequently, having a low portfolio duration means that the fund will be less affected by changes in interest rates than a corporate bond fund with a higher portfolio duration.

An in-house team of credit analysts assists the fund manager with individual credit selection along with the monitoring of the companies that issue the bonds held by the fund.

Fund information

Risk profile

The fund invests in a range of typically low-risk debt instruments, or bonds, that are typically repaid over three years. It is, therefore, subject to the price volatility of the global bond market as well as the performance of individual issuers. In addition, the fund is subject to fluctuations in currency exchange rates.

Debt securities with a short time until their final repayment date tend to be highly liquid, meaning that they can be easily bought or sold. The fund's exposure to debt securities may be gained through the use of derivatives. In association with the use of derivatives, including those instruments not traded through an exchange, collateral is deposited in order to mitigate the risk that a counterparty may default on its obligations or become insolvent.

Portfolio diversification is key in managing liquidity and default risks as well as reducing market risk. The fund's risks are measured and managed as an integral part of the investment process.

The following table shows the risk number associated with the fund and is based on Sterling Class 'A' shares.

Low risk — High risk

Typically lower rewards — Typically higher rewards

1	**2**	3	4	5	6	7

The above number:

- is based on the rate at which the value of the fund has moved up and down in the past and is based on historical data so may not be a reliable indicator of the future risk profile of the fund.
- is not guaranteed and may change over time and the lowest risk number does not mean risk free.
- has not changed during this period.

Investment review

As at 3 December 2018, for the six months ended 30 November 2018

Performance against objective

Between 1 June 2018 (the start of the review period) and 3 December 2018, the M&G Short Dated Corporate Bond Fund delivered a negative total return (the combination of income and growth of capital) in its sterling share classes.

The fund's US dollar shares delivered a small positive return, but its euro and Swiss franc shares posted negative returns between 1 June 2018 and 26 October 2018. On 26 October 2018, the fund's non-sterling share classes merged into the M&G (Lux) Short Dated Corporate Bond Fund, a Luxembourg-authorised SICAV which was launched on that date.

In this reporting period, the fund has not met its objective of providing income* and capital growth, although it has over three and five years and since launch**.

* The fund's distribution and distribution yield are as shown in the 'Specific share class performance' tables in the 'Fund performance' section of the Interim Long Report and unaudited Financial Statements for M&G Investment Funds (2). This fund provides a variable level of income.

** For the performance of each share class, please refer to the 'Long-term performance by share class' table in the 'Fund performance' section of the Interim Long Report and unaudited Financial Statements for M&G Investment Funds (2).

To give an indication of the performance of the fund, the following table shows the compound rate of return, per annum, over the period to 3 December 2018 for Sterling Class 'A' (Income) shares and Sterling Class 'I' (Income) shares. Calculated on a price to price basis with income reinvested.

Long-term performance

	Six months 01.06.18 % [a]	Three years 03.12.15 % p.a.	Five years 03.12.13 % p.a.	Since launch % p.a.
Sterling [b]				
Class 'A'	-0.9	+1.6	+1.6	+3.1 [c]
Class 'I'	-0.8	+1.7	+1.7	+1.8 [d]

[a] Absolute basis.

[b] Price to price with income reinvested.

[c] 29 January 1993, the end of the initial offer period of the predecessor unit trust.

[d] 9 November 2012, the launch date of the share class.

Investment review

Please note past performance is not a guide to future performance and the value of investments, and the income from them, will fluctuate. This will cause the fund price to fall as well as rise and you may not get back the original amount you invested.

Investment performance

Volatility has returned to financial markets since the start of 2018, as a result of a range of factors that have included higher interest rates and inflation, political uncertainty and global trade tensions.

The US Federal Reserve raised interest rates in both June and September, making it a total of eight times US rates have risen since the great financial crisis about a decade ago (and announced one further hike shortly after the end of the reporting period in December). In the UK, much uncertainty remained about the eventual terms of the country's Brexit deal with the European Union (EU). This contributed to times of adverse sentiment towards UK bonds. Elsewhere, investors in Europe became concerned towards the end of the period about Italian proposals to increase the country's budget deficit. The plans, which met with opposition from the EU, were drafted after an anti-establishment party gained a strong presence in Italy's new coalition government.

Meanwhile, sentiment towards corporate bonds – and international stockmarkets – became increasingly affected by concerns of a trade war developing between the US and China. In addition, during the latter months of the review period, global economic growth forecasts began to moderate, which contributed to some weaker confidence in the outlook for corporate bonds and emerging markets. (Bonds are loans in the form of a security, usually issued by a government – government bonds – or company – corporate bonds – which normally pay a fixed rate of interest over a given time period, at the end of which the initial amount borrowed is repaid.)

These more challenging conditions led to losses across most parts of the bond market over the six-month period. Sterling-denominated corporate bonds generally suffered more than euro and US dollar-denominated corporate bonds, a pattern that was mirrored within core government bond markets.

The M&G Short Dated Corporate Bond Fund is, by its very nature, less sensitive to changes in interest rates than many of its peers. It therefore typically performs well relative to funds which invest in longer dated corporate bonds (issues which are due to be repaid over relatively long periods) in an environment of rising interest rates, while tending to benefit less from falling rates than such funds.

As a result, while the fund generally lost ground in the volatile market environment of the review period, its relative lack of sensitivity to changes in interest rates (known as duration) helped to protect it from some of the worst of the volatility; it therefore held up better than many of its peers.

Investment activities

In order to ensure that the fund's value and ability to provide an income stream does not fluctuate meaningfully with changes in the economic cycle, we closely monitor the amount of interest rate risk and credit risk that we take.

Interest rate risk reflects the fact that when interest rates rise, the interest payments on conventional fixed rate bonds become less attractive to investors, causing their prices to fall. Bonds with less time until their maturity date (that is, short-dated bonds) tend to be less sensitive to changes in interest rates than longer dated bonds.

Credit risk refers to a borrower's creditworthiness, that is, the likelihood of a borrower failing to service a loan, or default. As with rising interest rates, if investors perceive that a bond issuer's credit risk has increased, this would also tend to weigh on corporate bond prices.

Broadly, we continue to have a positive outlook on corporate bonds. We retained a sizeable exposure (accounting for around 25% of the fund) to asset-backed securities (ABS) over the period. ABS are bonds backed by assets including credit card receivables, car loans or mortgages, whose creditworthiness is based on the underlying assets, rather than on the company that issued the bonds. Furthermore, most ABS holdings are floating rate in nature and stand to benefit from rising interest rates through their variable rate coupons. Currently, the majority of our ABS positions are within UK residential mortgage-backed securities, while we also have some exposure to similar European assets.

After corporate bonds experienced considerable weakness in the latter stages of the reporting period, we are starting to see greater value in these assets once again, and are looking to add credit risk back into the portfolio on a name-by-name basis.

Our positive outlook for global growth is reflected in a small above-index position in financials – financials stand to benefit from a rising interest rate environment that helps their margins, while a strong economic backdrop means that corporate default levels should remain low.

Outlook

From a macroeconomic perspective, we expect both US and European economic growth to continue as we head into 2019, albeit at a potentially lower trajectory than we have seen this year. In the US, President Trump may well unveil some form of fiscal stimulus in 2019, as this will need to be done early enough to have an impact before he faces re-election the following year. Should this happen, it will likely extend the current economic cycle still further.

Meanwhile, Europe feels like it is slowly repairing itself, and while the European Central Bank is ending its substantial bond-buying programme (referred to as quantitative easing), its effects are still being felt. In the UK, while a number of potential outcomes to the Brexit conundrum remain in play, the majority of these should, in our view, result in bond yields being pushed higher. (Bond yield refers to the interest received from a fixed income security and is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.)

We continue to monitor closely the possible impact on markets should the US Federal Reserve be forced to raise interest rates higher or faster than investors currently expect due to the rapid onset of inflation. Political newsflow – from the US in particular – may cause further volatility, as we have seen during the escalating trade tensions between the US and China.

In our opinion, the biggest risk currently facing bond investors is a degree of complacency that they are invested in a 'safe' asset class when, in reality, an environment of sharply rising interest rates/yields will hurt traditional government and investment grade corporate bond funds. Investors therefore need to pay close attention to the interest rate risk they are running in their portfolios.

One way to protect against this risk is by buying shorter dated corporate bonds, which carry less interest rate risk, while still allowing investors to achieve the extra pick-up on offer for buying corporate over government bonds. Floating rate notes offer a similar approach, as their coupons increase in line with the underlying interest rate – as is also the case with many asset-backed securities. If, as we do, you believe in an improving global economy, then this should prove supportive for corporate issuers.

Matthew Russell

Fund manager

An employee of M&G Limited which is an associate of M&G Securities Limited.

Please note that the views expressed in this Report should not be taken as a recommendation or advice on how the fund or any holding mentioned in the Report is likely to perform. If you wish to obtain financial advice as to whether an investment is suitable for your needs, you should consult a Financial Adviser.

Classification of investments

The table below shows the percentage holding per sector.

	% of fund as at 30.11.18	31.05.18
FIXED INCOME		
Debt securities		
'AAA' credit rated bonds	14.59	16.49
'AA' credit rated bonds	11.38	13.74
'A' credit rated bonds	25.71	24.17
'BBB' credit rated bonds	32.28	29.24
'BB' credit rated bonds	2.54	2.47
'B' credit rated bonds	0.00	1.23
Bonds with no credit rating	12.95	12.75
Debt derivatives		
Credit default swaps	0.00	0.08
CURRENCY		
Forward currency contracts	(0.77)	(1.45)
CASH EQUIVALENTS		
'AAA' rated money market funds [a]	1.16	1.57
SHARE CLASS HEDGING		
Forward currency contracts for share class hedging	0.00	(0.06)

[a] Uncommitted surplus cash is placed into 'AAA' rated money market funds with the aim of reducing counterparty risk.

Portfolio transactions

for the six months to 30 November Portfolio transactions	2018 £'000	2017 £'000
Total purchases	100,229	160,390
Total sales	229,820	155,782

Purchases and sales exclude the cost and proceeds of 'AAA' rated money market funds.

Please note past performance is not a guide to future performance and the value of investments, and the income from them, will fluctuate. This will cause the fund price to fall as well as rise and you may not get back the original amount you invested.

The following chart and tables show the performance for two of the fund's share classes – Sterling Class 'A' (Income) shares and Sterling Class 'I' (Income) shares.

We show performance for these two share classes because:

- The performance of the Sterling Class 'A' (Income) share is what most individuals investing directly with M&G have received. It has the highest ongoing charge of all the sterling share classes. Performance is shown after deduction of this charge. All UK investors in the fund therefore received this performance or better.
- The performance of the Sterling Class 'I' (Income) share is the most appropriate to compare with the average performance of the fund's comparative sector. It is the share class used by the Investment Association in the calculation of the comparative sector's average performance. This share class is available for direct investment with M&G subject to minimum investment criteria, or via third parties who may charge additional fees. The performance shown takes the deduction of the ongoing charge for this share class into account but it does not take account of charges applied by any other party through which you may have invested.

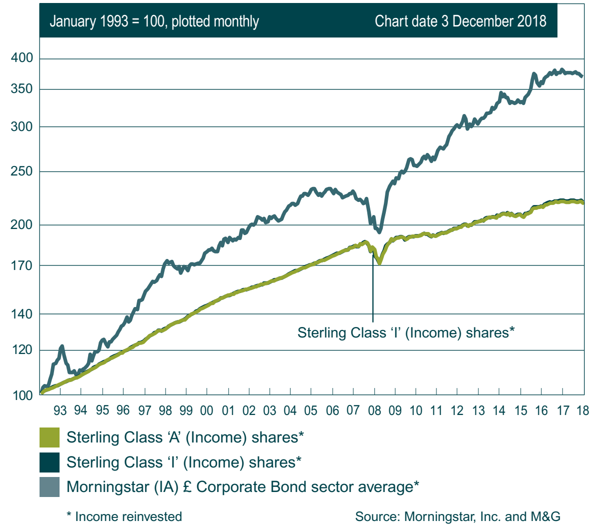
The fund is available for investment in different share classes, each with varying levels of charges and minimum investments; please refer to the Prospectus for M&G Investment Funds (2), which is available free of charge either from our website at www.mandg.co.uk/prospectuses or by calling M&G Customer Relations. For the specific performance tables of all share classes, please refer to the Interim Long Report and unaudited Financial Statements for M&G Investment Funds (2), which is available free of charge either from our website at www.mandg.co.uk/reports or by calling M&G Customer Relations.

Fund level performance

Fund net asset value			
as at	30.11.18 £'000	31.05.18 £'000	31.05.17 £'000
Fund net asset value (NAV)	347,553	472,648	454,383

Performance since launch

To give an indication of how the fund has performed since launch, the chart below shows total return of Sterling Class 'A' (Income) shares and Sterling Class 'I' (Income) shares.



The fund's Sterling Class 'I' (Income) shares were launched on 9 November 2012. Performance data shown prior to this date is that of the fund's Sterling Class 'A' (Income) shares.

Financial highlights
Fund performance

To give an indication of how the fund has performed during the period the tables below show the performance of Sterling Class 'A' (Income) shares and Sterling Class 'I' (Income) shares.

All 'Performance and charges' percentages represent an annual rate except for the 'Return after operating charges' which is calculated as a percentage of the opening net asset value per share (NAV). 'Dilution adjustments' are only in respect of direct portfolio transaction costs.

The non-sterling share classes were merged on 26 October 2018. The Distribution yields for the current year non-sterling share classes were calculated at the merger date.

Sterling Class 'A' Income share performance

The share class was launched on 29 January 1993.

Change in NAV per share	Six months to 30.11.18 UK p	Year to 31.05.18 UK p	Year to 31.05.17 UK p
Opening NAV	25.63	25.86	25.27
Return before operating charges and after direct portfolio transaction costs	(0.07)	0.35	1.19
Operating charges	(0.07)	(0.16)	(0.17)
Return after operating charges	(0.14)	0.19	1.02
Distributions	(0.26)	(0.42)	(0.43)
Closing NAV	25.23	25.63	25.86
Direct portfolio transaction costs	**UK p**	**UK p**	**UK p**
Costs before dilution adjustments	0.00	0.00	0.00
Dilution adjustments [a]	0.00	0.00	0.00
Total direct portfolio transaction costs	0.00	0.00	0.00
Performance and charges	**%**	**%**	**%**
Direct portfolio transaction costs [b]	0.00	0.00	0.00
Operating charges	0.51	0.64*	0.67
Return after operating charges	-0.55	+0.73	+4.04
Distribution yield	2.19	1.86	1.58
Effect on yield of charges offset against capital	0.50	0.62	0.65
Other information			
Closing NAV (£'000)	85,157	100,587	142,455
Closing NAV percentage of total fund NAV (%)	24.50	21.28	31.35
Number of shares	337,545,463	392,452,306	550,814,268
Highest share price (UK p)	25.78	26.07	26.05
Lowest share price (UK p)	25.37	25.67	25.29

* As the annual management charge was discounted during the period, 0.52% is a more reliable estimate of the operating charges for the period to 31.05.18.

Sterling Class 'I' Income share performance

The share class was launched on 9 November 2012.

Change in NAV per share	Six months to 30.11.18 UK p	Year to 31.05.18 UK p	Year to 31.05.17 UK p
Opening NAV	1,029.30	1,037.56	1,013.17
Return before operating charges and after direct portfolio transaction costs	(2.92)	13.99	47.97
Operating charges	(2.14)	(5.53)	(5.85)
Return after operating charges	(5.06)	8.46	42.12
Distributions	(10.56)	(16.72)	(17.73)
Closing NAV	1,013.68	1,029.30	1,037.56
Direct portfolio transaction costs	**UK p**	**UK p**	**UK p**
Costs before dilution adjustments	0.00	0.00	0.01
Dilution adjustments [a]	0.00	0.00	0.00
Total direct portfolio transaction costs	0.00	0.00	0.01
Performance and charges	**%**	**%**	**%**
Direct portfolio transaction costs [b]	0.00	0.00	0.00
Operating charges	0.41	0.53*	0.57
Return after operating charges	-0.49	+0.82	+4.16
Distribution yield	2.19	1.86	1.58
Effect on yield of charges offset against capital	0.40	0.52	0.55
Other information			
Closing NAV (£'000)	262,396	273,833	244,668
Closing NAV percentage of total fund NAV (%)	75.50	57.94	53.85
Number of shares	25,885,415	26,603,691	23,580,994
Highest share price (UK p)	1,035.47	1,046.19	1,044.98
Lowest share price (UK p)	1,019.20	1,030.88	1,013.86

* As the annual management charge was discounted during the period, 0.42% is a more reliable estimate of the operating charges for the period to 31.05.18.

[a] In respect of direct portfolio transaction costs.

[b] As a percentage of average net asset value.

We explain below the payments made to meet the ongoing costs of investing and managing the fund, comprising operating charges and portfolio transaction costs.

Operating charges

Operating charges include payments made to M&G and to providers independent of M&G:

- **Investment management:** Charge paid to M&G for investment management of the fund (also known as Annual Management Charge).
- **Administration:** Charge paid to M&G for administration services in addition to investment management – any surplus from this charge will be retained by M&G.
- **Share class hedging:** Charge paid to M&G for currency hedging services to minimise exchange rate risk for the share class.
- **Oversight and other independent services:** Charges paid to providers independent of M&G for services which include depositary, custody and audit.
- **Ongoing charges from underlying funds:** Ongoing charges on holdings in underlying funds that are not rebated.

Operating charges do not include portfolio transaction costs or any entry and exit charges (also known as initial and redemption charges). The charging structures of share classes may differ, and therefore the operating charges may differ.

Operating charges are the same as the ongoing charges shown in the Key Investor Information Document, other than where an estimate has been used for the ongoing charge because a material change has made the operating charges unreliable as an estimate of future charges.

For this fund there is no difference between operating charges and ongoing charges figures, unless disclosed under the specific share class performance table.

Portfolio transaction costs

Portfolio transaction costs are incurred by funds when buying and selling investments. These costs vary depending on the types of investment, their market capitalisation, country of exchange and method of execution. They are made up of direct and indirect portfolio transaction costs:

- **Direct portfolio transaction costs:** Broker execution commission and taxes.
- **Indirect portfolio transaction costs:** 'Dealing spread' – the difference between the buying and selling prices of the fund's investments; some types of investment, such as fixed interest securities, have no direct transaction costs and only the dealing spread is paid.

Investments are bought or sold by a fund when changes are made to the investment portfolio and in response to net flows of money into or out of the fund from investors buying and selling shares in the fund.

To protect existing investors, portfolio transaction costs incurred as a result of investors buying and selling shares in the fund are recovered from those investors through a 'dilution adjustment' to the price they pay or receive. As the fund invests mainly in fixed interest securities, the direct transaction costs paid on other investments are too small to be reflected in the table below. To give an indication of the indirect portfolio dealing costs the table below shows the average portfolio dealing spread.

Further information on this process is in the Prospectus, which is available free of charge on request either from our website at www.mandg.co.uk/prospectuses or by calling M&G Customer Relations.

Portfolio transaction costs

as at Indirect portfolio transaction costs	30.11.18 %	31.05.18 %	31.05.17 %	Average [a] %
Average portfolio dealing spread	0.41	0.31	0.31	0.34

[a] Average of first three columns.